

INTERESTS IN SECURITIES

A Proprietary Law Analysis of the
International Securities Markets

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B. The Legal Nature of Interests in Securities

the bailor retains title to them.⁴² Other examples of bailment are the storage of goods in warehouses and the placing of jewellery in safety deposit boxes.

However, because bailment is based on possession, it can only relate to tangible assets. Interests in securities cannot be the subject of bailment, because they are intangible.⁴³ The rise of interests in securities therefore requires the traditional custodial relationship to be reappraised, as discussed below.⁴⁴ 2.32

(2) Indirect Interests

Interests in securities confer on their holders rights of property in relation to the underlying securities.⁴⁵ However, they only do so indirectly, as against the intermediary in whose account the interests in securities are recorded. As discussed in Chapter 1, the holder of an interest in securities does not have a direct claim against the issuer of the underlying securities.⁴⁶ She has an economic interest in the underlying securities, but this must normally be enforced through the intermediary or intermediaries that stand between her and the issuer in the chain of ownership. 2.33

Chapter 13 will consider the difference between personal and property rights. It will argue that intangible assets (such as interests in securities) are only subject to property rights *as against* intermediaries. Thus, where debt securities are held for an investor by a custodian, the rights of the investor *as against the custodian* are proprietary, in the sense that they will not be at risk in the insolvency of the custodian. However, as against the issuer, any rights in relation to the debt securities are personal, because of course the rights of investors are at risk in the insolvency of the issuer. See Chapter 13 for a further discussion. 2.34

Intermediary credit risk; bailment and trust

Whenever a client entrusts her assets to an intermediary, she is concerned to ensure that her assets will not be treated as part of the intermediary's own estate, but that they will be treated as a separate fund (ie separate from the intermediary's own assets). This is because she wishes to ensure that creditors of the intermediary 2.35

⁴² Although in the normal course, delivery of a bearer instrument passes title, the effect of delivery can be varied by the intention of the parties. Thus, delivery for the purposes of safekeeping creates a bailment (and delivery by way of security creates a pledge). The bailee acquires a limited legal interest, which enables it to pass good title to a purchaser.

⁴³ Equally registered securities cannot be bailed, because they are also intangible.

⁴⁴ See also the discussion of custody in Chapter 10.

⁴⁵ To be exact they confer indirect rights on the underlying (*interests in*) securities. However, for the sake of simplicity, it will be assumed in this discussion that the asset held by the intermediary in whose accounts the interests in securities are recorded, are securities, so that only one intermediary is involved.

⁴⁶ As indicated in Chapter 1, this is the usual position. A participant in a settlement system may be given conditional rights against the issuer under deed poll, which arise in the event of default. For the meaning of the term 'deed poll', see Blackstone (n 14 above) vol 2, 296.